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In the Supreme Court of the United States

OCTOBER TERM, 1949

Nos. 622 to 630

B. D. PHILLIPS, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 122a-140a) are reported at 8 T. C. 1286. A further opinion of the Tax Court (R. 154a-158a) is reported at 11 T. C. 653. The opinion of the Court of Appeals (R. 174-176) is reported at 178 F. 2d 270.

JURISDICTION

The judgments of the Court of Appeals were entered on December 2, 1949. (R. 176-184.) The

petition for writs of certiorari was filed on February 24, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

The Commissioner and a corporation entered into a closing agreement, on Form 866, relating to the tax liability of the corporation for particular years. The questions presented are:

1. Was the court below correct in holding that the closing agreement was conclusive only with respect to the ultimate tax liability of the corporation, and that it did not constitute an agreement with respect to any particular items which may have entered into that tax liability, such as the status of the corporation's earnings and profits account?

2. Was the court below correct in holding that, irrespective of what may have been agreed upon by the corporation and the Commissioner, the agreement possessed no binding effect with regard to matters affecting the tax liabilities of the corporation's stockholders who were strangers to the agreement?

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and Regulations involved are set forth in the Appendix, *infra,* pp. 12-15.

STATEMENT

The taxpayers are stockholders of the Pennsylvania Investment and Real Estate Corporation, which will be referred to as the corporation. In 1941, the corporation made distributions to its stockholders, giving rise to the ultimate tax issue in this case, *i. e.,* whether the distributions were taxable as dividends to them, under the definition of "dividends" contained in Section 115 (a) of the Internal Revenue Code.[1] (R. 122a-125a.)

The corporation was formed in December, 1928. All its stock was issued to the T. W. Phillips Gas & Oil Company for certain assets of that company, in accordance with a non-taxable reorganization. These shares were distributed by the T. W. Phillips Gas & Oil Company to its shareholders on a share for share basis. (R. 125a-126a.)

In 1940, upon an audit of the corporation's tax return for the years 1938 and 1939, the Internal Revenue Agent disallowed a dividends paid credit which the corporation had taken for those years, the disallowance being explained on the ground that the distributions were in excess of the corporation's accumulated earnings and profits, and that they did not constitute taxable dividends includible

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[1] With exceptions not material here, Section 115(a) defines taxable dividends as "any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * *."

in the dividends paid credit. In December, 1940, the corporation submitted to the Commissioner a closing agreement on Form 866 ("Agreement as to final determination of tax liability"), agreeing to the amounts of tax for the years 1938 and 1939, as adjusted by the agent on the audit. A revised closing agreement, agreeing to the same tax deficiencies, was executed by the corporation on December 30, 1940, by the Commissioner on March 8, 1941, and was approved by the Acting Secretary of the Treasury on March 18, 1941. (R. 126a-128a.)

The earnings of the corporation from the date of its incorporation to December 31, 1940, were less than the distributions which it made during this period; in 1941 it suffered a net loss. (R. 126a.) No earnings of T. W. Phillips Gas & Oil Company were entered on the books of the corporation as a result of the 1928 non-taxable reorganization (R. 130a), and the possibility that such earnings were inherited and should have entered into its earnings and profits account for tax purposes was apparently not considered by the parties at the time of the closing agreement (R. 138a).

At the first hearing before the Tax Court (R. 5a-81a), in support of their contention that the corporation had no earnings and profits in 1941, and that the distributions which they received were therefore not taxable dividends under Section 115 (a), the taxpayers offered no evidence except in relation to the closing agreement and the surround-

ing circumstances. The Tax Court ruled that the closing agreement was only a final determination of the ultimate tax liability of the corporation and was not (R. 130a) "an agreement as to any specific matters or methods used in computing the amount of such tax liability." It held that, since the closing agreement did not preclude an independent determination in the present proceeding of the amount of the corporation's accumulated earnings and profits, it remained for the taxpayers to offer such evidence at a further hearing, if they desired one. (R. 131a-140a.) The taxpayers moved for a further hearing (R. 140a-141a), but failed to introduce any further evidence (R. 143a-154a). Thereafter, the Tax Court again held that the taxpayers had not sustained the burden of proof and that the Commissioner's deficiency determinations were required to be sustained. (R. 154a-158a.)

The Court of Appeals, in a *per curiam* opinion, affirmed the decision of the Tax Court. (R. 175-176.)

ARGUMENT

1. The sole issue in this case is whether the taxpayers, who are stockholders of a corporation, can establish that the distributions which they received were not taxable dividends, because not distributed out of the corporation's earnings and profits, simply by showing that the Commissioner and the corporation entered into an agreement with respect

to the amount of the corporation's tax liability in prior years, and by offering to prove that the agreed-upon liability had been computed on the basis of certain assumptions or findings as to the then status of the corporation's earnings and profits account. The decision below is correct in holding that the closing agreement, which was executed on Form 866, determined only the amount of the corporation's ultimate tax liability for the years 1938 and 1939, and that there was no statutory agreement respecting any of the factual matters or particular items on which the tax liability had been computed.

Section 3760 of the Internal Revenue Code (Appendix, *infra,* p. 12), authorizes the Commissioner to enter into a written agreement with any person relating to the tax liability of such person. The agreement, when approved by the Secretary of the Treasury, is final and conclusive and the case may not be reopened with respect to the "matters agreed upon." The matters agreed upon "may relate to the total tax liability of the taxpayer," or to "one or more separate items affecting the tax liability of the taxpayer." T. D. 4855, Appendix, *infra,* p. 13. Ever since 1928, the Bureau of Internal Revenue has used two different forms to cover agreements relating to these different matters—Form 866 entitled "AGREEMENT AS TO FINAL DETERMINATION OF TAX LIABILITY" (set forth at R. 163-170), and Form 906, entitled "CLOSING

AGREEMENT AS TO FINAL DETERMINATION COVERING SPECIFIC MATTERS" (set forth at R. 161-162). As is evident both from their titles and their contents, Form 866 is used only when the agreement is to relate solely to the ultimate tax liability, while Form 906 is used when specific facts, as well as final tax liabilities, are to be the subject of agreement. Mim. 4821, 1938-2 Cum. Bull. 254; Mim. 4149, XIII-1 Cum. Bull. 162 (1934); Oliphant, *The Administrative Decision in Taxes,* 27 Mich. State Bar J. 5, 9-10 (1948).

The agreement in this case was on Form 866 and there is nothing in the instrument evidencing an agreement on anything except the specific tax liabilities there set forth. (Pet. Ex. 19, R. 94a-95a.) The petitioners' position is based entirely on the supposition that the closing agreement settled not only the tax liabilities there listed but also the factual assumptions on which that tax liability was allegedly computed, but which do not appear in the agreement. Specifically, their contention is that the agreement irrevocably determined the status of the corporation's earnings and profits account as of that time, and that they are entitled to go behind the closing agreement to show the factual basis on which the computations were made. (Pet. 11-12, 14.)

The conclusive answer to this contention lies in the fact that the only "matters agreed upon" in the closing agreement were the ultimate tax lia-

bilities of the corporation. Accordingly, those are the only matters which can be granted finality under Section 3760 of the Internal Revenue Code. There was no statutory agreement relating to the facts (including the status of the earnings and profits account) underlying the tax liabilities, and there could have been none except by using Form 906 and by listing the specific matters on which an agreement was reached. There is absolutely nothing in the record to show that the corporation desired to have a determination of its earnings and profits account which would have been binding for all time, or that the Commissioner would have been willing to enter into such an agreement even if one had been submitted by the corporation. Both parties may have wanted to be free to controvert this fact to the extent that it might affect tax liability in other years.

None of the cases cited by the taxpayers (Pet. 13, fn. 1) support their fundamental contention that a closing agreement which relates to tax liability alone is also a conclusive determination regarding the underlying facts where they affect tax liability in some other year. Indeed, the only authorities are to the contrary. *Mitchell Co.* v. *Commissioner,* 27 B. T. A. 645; *Alabama Mineral Land Co.* v. *Commissioner,* 28 B. T. A. 586; *Smith Paper Co.* v. *Commissioner,* 31 B. T. A. 28, affirmed *sub nom. Export Leaf Tobacco Co.* v. *Commissioner,*

78 F. 2d 163 (C. A. 2), certiorari denied, 296 U. S. 627.

Another fatal defect in the petitioners' case is the fact that the closing agreement was entered into between the corporation and the Commissioner. Even if the agreement had been on Form 906 and had specifically involved the status of the corporation's earnings and profits account, the agreement would not have been conclusive either for or against the present taxpayers, who are stockholders of the corporation. Section 3760 only authorizes an agreement "with any person relating to the liability of such person * * *." Such an agreement is not conclusive respecting the tax liability of any other person, even though their tax liabilities are controlled by the same basic facts. *Anthracite Trust Co.* v. *Commissioner*, 26 B. T. A. 89. These stockholders were not and could not have been parties to this agreement since it did not relate to their tax liabilities. With regard to facts which would affect the stockholders' taxes for any year, including the very years covered by the agreement,, neither they nor the Commissioner could be precluded by anything in the Commissioner's agreement with the corporation. The court below correctly held that the stockholders were strangers to the agreement and were "neither bound by it nor can they take advantage thereof." (R. 176.)

The taxpayers make an alternative argument (Pet. 15-16) that the closing agreement, if not conclusive, constituted *prima facie* evidence that the corporation possessed no earnings and profits from which dividends could be distributed. This argument, however, also rests on the fallacious premise which underlies the principal contention, namely, that the effect of the closing agreement (Pet. 16) "was to determine finally that the corporation had no undistributed earnings as of the end of 1939." As we have shown, the agreement had no such effect.

To prevail in this controversy, the taxpayers had to establish that the corporation possessed no earnings and profits in 1941 out of which dividends could be distributed. Except by reference to the closing agreement, the taxpayers made no attempt to introduce any positive evidence which would show what was the status of the earnings and profits account. They even failed to do so after moving the Tax Court for leave to file additional evidence. (R. 140a-141a, 143a-153a.) In the absence of any competent proof to support the taxpayers' petitions, the Tax Court had no alternative but to sustain the Commissioner's deficiency determinations. *Welch* v. *Helvering,* 290 U. S. 111, 115; *Helvering* v. *Gowran,* 302 U. S. 238.

2. There is no conflict in decisions and none is asserted by the taxpayers. No other reason

exists which would warrant further review of these cases.

CONCLUSION

The petition for writs of certiorari should be denied.

Respectfully submitted,

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MARCH, 1950.

APPENDIX

INTERNAL REVENUE CODE:

SEC. 3760. CLOSING AGREEMENTS.

(a) *Authorization.*—The Commissioner (or any officer or employee of the Bureau of Internal Revenue, including the field service, authorized in writing by the Commissioner) is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period.

(b) *Finality.*—If such agreement is approved by the Secretary, the Under Secretary, or an Assistant Secretary, within such time as may be stated in such agreement, or later agreed to, such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—

(1) The case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of the United States, and

(2) In any suit, action, or proceedings, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

(26 U. S. C. 1946 ed., Sec. 3760.)

T. D. 4855, 1938-2 Cum. Bull. 252, promulgated under Section 3447, Revised Statutes, and made applicable to the Internal Revenue Code by T. D. 4885, 1939-1 Cum. Bull. (Part 1) 396:

> Article 1. *Closing agreements relating to tax liability in respect of internal-revenue taxes.*—Closing agreements provided for in section 606 of the Revenue Act of 1928, as amended, may relate to any taxable period ending prior or subsequent to the date of the agreement. With respect to taxable periods ending prior to the date of the agreement, the matter agreed upon may relate to the total tax liability of the taxpayer or it may relate to one or more separate items affecting the tax liability of the taxpayer, as for example, the amount of gross income, deductions for losses, depreciation or depletion, or the year for which an item of income is to be included in gross income or the year for which an item of loss is to be deducted, or the value of property on a specified date. A closing agreement may also be entered into in order to provide a "determination under the income tax laws" as defined in section 820 (a) (1) (A) of the Revenue Act of 1938. With respect to taxable periods ending subsequent to the date of the agreement, the matter agreed upon may relate only to one or more separate items affecting the tax liability of the taxpayer. The following, among others, are examples of the latter type of closing agreement: (1) A taxpayer

may sell a portion of his holdings in a particular stock. A closing agreement may be entered into fixing the cost or other legal factor determining the basis for computing gain or loss on such sale, and, at the same time fixing the cost or other legal factor determining the basis (unless or until the statute is changed to require the use of some other factor to determine basis) of the remaining portion of the stock still held by the taxpayer upon which gain or loss will be computed when the taxpayer sells such stock in a later year; (2) if the taxpayer is undecided whether to sell property or hold it, or as to the price at which to sell it, a closing agreement may be entered into determining the market value of the property as of March 1, 1913, for future taxable periods, prior to the consummation of the sale by the taxpayer. A closing agreement with respect to any taxable period ending subsequent to the date of the agreement is subject to any change in or modification of the law enacted subsequent to the date of the agreement and applicable to such taxable period, and each closing agreement shall so recite. Closing agreements may be executed even though under the agreement the taxpayer is not liable for any tax for the period to which the agreement relates. There may be a series of agreements relating to the tax liability for a single period. Any tax or deficiency in tax determined pursuant to a closing agreement shall be assessed and col-

lected, and any overpayment determined pursuant thereto shall be credited or refunded in accordance with the applicable provisions of law.

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